

Message Text

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60

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TAGS: ECON, EFIN, EGEN, CI

SUBJ: CHILE'S GENERAL ECONOMIC SITUATION -SUMMARY OF SANTIAGO

A-95

1. THE GOC'S INITIAL SUCCESS IN MOVING THE ECONOMY TOWARD RECOVERY IN LATE 1973 IS BEING ERODED BY AN UNANTICIPATED HIGH RATE OF INFLATION, WHICH REACHED 62 PERCENT DURING THE FIRST QUARTER OF 1974. THE INFLATION HAS BROUGHT GOC ECONOMIC ADVISORS UNDER FIRE. THEY HAVE BEEN ABLE TO CONVINCE THE JUNTA OF THE VALIDITY OF THE POLICIES THEY RECOMMEND, HOWEVER, LARGELY BECAUSE THOSE HOLDING OPPOSING VIEWS ARE UNABLE TO DEMONSTRATE PROSPECTS OF GREATER SUCCESS.

2. GOC'S ORIGINAL GOAL WAS TO HOLD INFLATION TO NOT MORE THAN 100 PERCENT IN 1974; OFFICIALS NOW PRIVATELY TALKING IN TERMS OF 150-200 PERCENT, WHICH SOME OBSERVERS FEEL STILL TOO OPTIMISTIC. IN FIRST QUARTER, ABOUT ONE-THIRD OF THE INFLATION CAME DIRECTLY FROM INCREASES IN PRICES OF BREAD AND PETROLEUM. ANOTHER IMPORTANT SOURCE OF INFLATION WAS EXCESSIVE EXPANSION OF THE MONEY SUPPLY, PRIMARILY CAUSED BY DECENTRALIZED AGENCIES AND STATE-OWNED ENTERPRISES WHICH ARE DISREGARDING GOC SPENDING RESTRICTIONS, FURTHER INFLATION RESULTED FROM CENTRAL BANK PURCHASE DURING THE PERIOD FOR ESCUDOS OF SOME \$70 MILLION US DOLLARS HELD BY CHILEANS, AS WELL AS A RAPID INCREASE IN THE RECEIPTS OF A VARIETY OF INDUSTRIES PRODUCING FOR EXPORT. THE

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FOREIGN SECTOR IS STILL STRONGLY NEGATIVE AND THEREFORE ANTI-

INFLATIONARY, BUT AS THE TRADE ACCOUNT IS MOVING TOWARD BALANCE THIS BRAKE IS BEING LET UP.

3. GOC ECONOMIC ADVISERS ARE PROPOSING A TWO-PART ANTI-INFLATIONARY PROGRAM: REDUCE PUBLIC SECTOR DEFICITS AND INCREASE IMPORTS. THE GOC IS ALSO ENGAGING IN A GREAT DEAL OF JAW-BONING, INCLUDING GRAVE THREATS TO PRODUCERS AND RETAILERS WHO VIOLATE RULES OF THE GAME. THE PROBLEM IS THAT A REALLY EFFECTIVE CLAMP-DOWN ON MONEY SUPPLY COULD SERIOUSLY AFFECT PRODUCTION AT A TIME WHEN CHILE CANNOT AFFORD A DROP IN REAL OUTPUT. THE ONLY VIABLE ALTERNATIVE IS TO PUT UP WITH A HIGHER THAN DESIRED LEVEL OF INFLATION FOR THE NEXT FEW MONTHS, AN INFLATION WHICH WILL INCREASINGLY TEND TO FEED ON ITSELF THROUGH WAGE AND PRICE ADJUSTMENTS.

4. OFFICIAL GOC FIGURES INDICATE SANTIAGO AREA UNEMPLOYMENT OF 7 PERCENT, BUT UNOFFICIAL SOURCES PLACE FIGURE CLOSER TO 10 PERCENT MARK. GOC REALIZES UNEMPLOYMENT RATE WILL INCREASE, AND HAS PLANS TO PROVIDE BENEFITS TO THOSE LOSING JOBS DUE TO AUSTERITY MEASURES. THERE WILL ALSO BE A GENERAL WAGE ADJUSTMENT EFFECTIVE MAY 1, WHICH, WHILE IT PROBABLY WILL DISCRIMINATE IN FAVOR OF THE LOWER INCOME GROUPS, PROBABLY WILL ALSO RESULT IN FALL IN AGGREGATE PURCHASING POWER COMPARED WITH THE BEGINNING OF 1974. THOSE MOST AFFECTED BY AUSTERITY WILL BE THE UNEMPLOYED, UNDEREMPLOYED, PENSIONERS, AND THAT PART OF THE MIDDLE CLASS DEPENDENT ON WAGE AND SALARY INCOME. THOSE WITH STEADY JOBS AT LOWER LEVELS WILL BENEFIT MOST, IN RELATIVE TERMS, FROM SPECIAL BONUSES AND OTHER PROVISIONS WHILE THE WELL-TO-DO AND THE SELF-EMPLOYED WILL BE BETTER ABLE TO FEND FOR THEMSELVES.

5. RECOVERY OF FOREIGN SECTOR HAS BEEN DRAMATIC -BUOYED UP BY RECORD SETTING HIGH PRICE OF COPPER. EVEN THOUGH PRICES OF ESSENTIAL IMPORTS, PARTICULARLY FUEL AND GRAIN, ARE ALSO UP SHARPLY, THE PROJECTED TRADE ACCOUNT DEFICIT IS DOWN TO ABOUT \$360 MILLION FROM THE ESTIMATE OF \$620 MILLION WHICH CHILE PRESENTED TO CIAP IN JANUARY. THE 1973 BOP DEFICIT WAS ALSO LOWER THAN ANTICIPATED, AND DISPOSABLE CENTRAL BANK FOREIGN EXCHANGE REPORTEDLY IS UP FROM \$3 MILLION ON SEPT 11 TO \$300 MILLION IN MID-APRIL. THE CAPITAL ACCOUNT HAS ALSO IMPROVED MARKEDLY DUE TO THE FAVORABLE PARIS CLUB AGREEMENT ON DEBT RE-

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SCHEDULING, PRIVATE FOREIGN BANK SHORT-TERM LENDING ESTIMATED TO EXCEED \$200 MILLION AND THE RECENT \$22 MILLION IDB LOAN, WITH OTHER IFI AND BILATERAL CREDITS EXPECTED TO FOLLOW SOON.

6. EXCHANGE RATE POLICY HAS BEEN LESS IMPRESSIVE. AFTER INITIAL LARGE DEVALUATION OCT 1 RATE WERE SUPPOSED TO DEVALUE PARI PASSU WITH DOMESTIC INFLATION. RESISTANCE DEVELOPED TO DEVALUATION OF BANKERS' RATE AT LEVELS MATCHING THE LARGE RISE

IN CPI, AND THE DECISION TO APPRECIATE THE BROKERS' RATE HAS MADE FOREIGN GOODS AND TRAVEL RELATIVELY CHEAP.

7. GOC HAS SET GDP GROWTH GOAL OF 6 PERCENT FOR 1974. EMBASSY VIEWS GROWTH AS HIGH AS 8 PERCENT A POSSIBILITY. MORE IMPORTANTLY, GROWTH WILL BE CENTERED IN INDUSTRY (8 PERCENT), AGRICULTURE (10 PERCENT), AND MINING (30 PERCENT), INCREASES OF 1974 OVER 1973 MUST BE ACHIEVED MAINLY THROUGH EFFICIENCIES AS LITTLE NEW CAPACITY WILL BE AVAILABLE. GOC IS EMPHASIZING PRODUCTION FOR EXPORT MARKETS OR IMPORT SUBSTITUTION (AGRICULTURE). AUSTERITY CAUSES LOCAL CONSUMER DEMAND FOR MANY PRODUCTS TO BE WEAK. DEMAND FOR LOCALLY PRODUCED CAPITAL GOODS REPORTEDLY IS STRONG.

8. GOC IS SEARCHING FOR WAYS TO ENCOURAGE LOCAL SAVINGS AND INVESTMENT AS WELL AS FOREIGN INVESTMENT, WITHOUT MUCH SUCCESS. COMMERCIAL BANKS' INTEREST RATES HAVE BEEN RAISED TO 90 PERCENT ANNUALLY BUT ARE STILL NEGATIVE. GOC MUST THEREFORE RELY HEAVILY ON FOREIGN INVESTMENT FOR RECOVERY. FOREIGN COMPANIES ARE CLEARLY INTERESTED, BUT WAITING IN THE WINGS A FEW MORE MONTHS PENDING EVIDENCE GOVERNMENT IS FIRMLY IN POWER AND COMMITTED TO RATIONAL ECONOMIC POLICIES.

9. GOC IS ATTEMPTING TO REDUCE ITS ROLE IN THE ECONOMY, WHICH HAD EXPANDED TO CONTROL OF 50 PERCENT OF GDP AND ABOUT 50 PERCENT OF THE COUNTRY'S ARABLE LAND. THE GOVERNMENT DEVELOPMENT CORPORATION, CORFO, GAINED CONTROL OF SOME 500 FIRMS, HAS RETURNED ABOUT 150, AND IS STRUGGLING TO GET RID OF ABOUT 130 MORE. THE PROBLEM IS THAT THE PRIOR OWNERS OFTEN DO NOT WANT THE COMPANIES BACK UNDER THE TERMS CORFO HAS SO FAR IMPOSED, AND THE SHARES CANNOT BE DUMPED ON THE STOCK MARKET WITHOUT DISASTROUS EFFECTS ON PRICE.

10. FERNANDO LENIZ AND RAUL SAEZ, MOST INFLUENTIAL ECONOMIC
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ADVISERS, ARE HARD PRESSED TO CARRY OUT ALL THEIR ASSIGNMENTS. GOC CAN ALSO COUNT ON OCCASIONAL ASSISTANCE OF CARLOS MASSAD, SOUTHERN CONE EXECUTIVE DIRECTOR FOR THE IMF, AND JORGE CAUAS IS SCHEDULED TO RETURN AS VICE PRESIDENT OF THE CENTRAL BANK THIS MONTH. THERE IS SOME CONFLICT BETWEEN THE MINISTERS AND GENERAL CANESSA'S ADVISORY COMMITTEE TO JUNTA, BUT THIS DOES NOT APPEAR TO BE A SERIOUS PROBLEM AT PRESENT. MINISTERS AND ADVISERS MEET FREQUENTLY WITH ADMIRAL MERINO, THE JUNTA MEMBER RESPONSIBLE FOR ECONOMIC POLICY. HE IS A CAPABLE MAN, BUT HE DOES NOT HAVE TIME TO DEAL WITH SUBJECT IN SUFFICIENT
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